

## MEMORANDUM

From: USAC High Cost Compliance and Verification Team

To: Federal Communications Commission, Wireline Competition Bureau

Date: February 24, 2017 (revised March 6, 2017 and April 10, 2017)

Re: USAC Review of Allband Communications Cooperative  
WC Docket No. 10-90

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### Background

Allband Communications Cooperative (Allband or ACC) is a rate-of-return incumbent local exchange carrier providing voice and broadband service in rural Michigan since 2006. ACC, the regulated entity formed in 2003, wholly owns an unregulated subsidiary, Allband Multimedia LLC (AMM), formed in 2009, through which it has offered broadband and VoIP services since 2012.

On July 20, 2016, the Federal Communications Commission (FCC or Commission) denied ACC's Petition for Further Waiver of section 54.302 of the FCC's rules.<sup>1</sup> In its decision the Commission found that Allband's accounting was unreliable, and as a result, the Commission was unable to determine whether support in excess of the \$250 cap was justified. Based on work performed by USAC's Internal Audit Division (IAD), the Commission noted several instances of noncompliance, including:

- Misallocation of employee time;
- Unrealistically high percentage of corporate operations expenses allocated to regulated activities;
- Non-compliance with affiliate transactions rules; and
- Inclusion of improper expenditures.

The Commission ordered Allband to revise its cost accounting practices to comply with the FCC's rules. USAC was directed to review Allband's revised cost accounting practices, for at

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<sup>1</sup> *Connect America Fund Allband Communications Cooperative Petition for Waiver of Certain High-Cost Universal Service Rules*, WC Docket No. 10-90, Order and Order on Review, FCC 16-94 (2016) (*Allband Order*). In 2011 the Commission adopted Section 54.302, establishing a presumptive per line cap of \$250 per month on total high-cost universal service support. Allband received a waiver to receive support above the \$250 cap beginning in July 2012. *Allband Communications Cooperative Petition for Waiver of Certain High-Cost Universal Service Rules*, WC Docket No. 10-90, Order, 27 FCC Rcd 8310, 8315, para. 15 (WCB 2012).

least a three-month period, in order to assess whether Allband's revisions now adhere to the Commission's rules.<sup>2</sup>

This memo summarizes the results of USAC's review of Allband's revised cost accounting for the first and second quarters of 2016.<sup>3</sup> The USAC High Cost Compliance and Verification Team performed this review by conducting interviews with Allband staff and consultants as well as by testing transactions on a sample basis. Included as part of our discussion with Allband was a trip by USAC High Cost staff to Allband's Michigan headquarters. During testing, USAC reviewed a sample of selected expense transactions from Allband's general ledger for the first and second quarters of the year as well as a sample of employee labor hours from the second quarter of the year. USAC determined that the above actions would enable USAC to conclude as to whether Allband's cost accounting revisions now adhere to the Commission's rules.

We note that paragraph 24 of the Allband Order instructs USAC to apply revised methodologies to Allband's costs during the interim waiver period from June 30, 2015 to the date of the Allband Order to determine what Allband's support would have been had it correctly allocated its costs and to initiate recovery actions for all high cost loop support (HCLS) and interstate common line support (ICLS) support in excess of the amounts of support Allband should have received from that period. Paragraph 25 of the Allband Order directs USAC to conduct an inquiry to examine Allband's cost allocations during the initial waiver period (2012-2015) to determine whether Allband was overcompensated by the Universal Service Fund during that period. USAC has not yet initiated the directives set forth in paragraphs 24 and 25 of the Allband Order.

### **Misallocation of Employee Time**

The *Allband Order* raises several issues regarding the misallocation of employee time. First, the Commission expressed concern that "there were significant errors ACC made in the classification of the employees' time that was reported on timesheets and recorded in the general ledger."<sup>4</sup> USAC reviewed Allband's revised procedures and found that its time reporting process has significantly evolved. Allband created separate timesheets to clearly report time for either ACC or AMM. More recently, Allband started using a program known as Harvest, which further enhances the accuracy of reporting. Harvest ensures there are no calculation errors in the timesheet process. Harvest also uses user profiles tied to an individual employee's role, such as "Admin," to restrict what Part 32 accounts should be available to employees for allocating time worked. For example, an outside plant technician would not have access to Regulatory Filings & Compliance (672000) to charge time to that account. Further, Allband trained plant personnel to ensure that time associated with loading trucks or traveling to an AMM task was not classified as regulated time.

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<sup>2</sup> *Allband Order* at para. 23.

<sup>3</sup> *See id.* at para. 23 & n.80.

<sup>4</sup> *Id.* at para. 10.

To evaluate whether Allband's adjustments were effective, and to assess if employee time was being charged to the correct Part 32 account, USAC High Cost tested one timesheet for each employee who reported time during the second quarter of 2016. USAC reviewed a total of 31 timesheet transactions for nine employees. Of the 31 transactions reviewed, USAC noted exceptions for four transactions. Exhibit I provides additional details for the four exceptions. Three of the four transactions lacked supporting documentation and were all associated with a single employee. In response to the missing documentation, Allband described that, in 2016, personnel received training on proper time keeping including management's expectation that employees document customer names and work order tickets as part of their daily timesheets along with details of work performed. Management has committed to monitor employee compliance with this requirement and to make corrections where required. This improved process should enable regulatory staff to identify supporting documentation in an efficient manner. The fourth exception involved misusing the general computer expense account. USAC explained the exception and educated Allband about how to allocate employee time using the appropriate account. Allband has indicated that it now understands the proper use of the general computer expense account, and that in the future similar employee time will be properly allocated instead of being automatically assigned to the general computer expense account.

USAC also evaluated how Allband reported time associated with the employee morning meetings due to issues raised by the Commission. Specifically, the Commission found that a portion of the time spent in morning meetings should have been allocated to AMM instead of 100% allocated to ACC.<sup>5</sup> Further, the Commission instructed that time associated with morning meetings should be "expressed in line with the employees' normal job duties" rather than assessed entirely to the general and administrative account.<sup>6</sup> In order to evaluate Allband's revised reporting of employee morning meeting time, USAC reviewed the second quarter payroll summary for ACC. USAC observed that employee morning meeting time is now allocated, at the end of each quarter, to ACC regulated and nonregulated categories or to AMM based on activities performed by the relevant employees during the quarter. For example, if an employee were engaged in inventory count for 5% of the quarter, 5% of the morning meeting time for that employee would be associated with the inventory activity. USAC determined this was a reasonable method of allocating morning meeting time and that it was in-line with the approach specified by the Commission in the *Allband Order*.

### **Corporate Operations Expenses Allocated to Regulated Activities**

In the *Allband Order* the Commission also expressed concern about the unusually high allocation of employee time for corporate operations and corporate operations expenses to regulated activities.<sup>7</sup> Allband took actions to address the concerns raised by the Commission.

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<sup>5</sup> *Id.* at para. 12.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at para. 15 ("In 2014, Allband allocated 95 percent of employee time to the regulated entity. Included in that allocation is executive time, of which Allband allocated 98 percent to the regulated entity. Allband attributes these high percentages to executive and management time spent dealing with regulatory and legal proceedings, which

First, Allband revised its accounting practices to more accurately assign employee time spent on corporate operations. As a result, the majority of employee time in the second quarter of 2016, approximately 57%, is now classified as non-regulated ACC or AMM. Allband now identifies employee time that can be directly assigned to regulated or nonregulated classifications of ACC or to AMM. For employee time that cannot be directly assigned, Allband developed specific allocators to distribute corporate operations “time.” Allband uses several category-driven allocators where direct assignment is not possible. The “plant general allocator” is based on the time of outside plant employees and is used to allocate certain outside plant expenses reported in the general ledger. The “customer service general allocator” is based on the proportion of customer service personnel time directly reported as ACC regulated, ACC non-regulated, and AMM. The customer service general allocator percentages are then used to allocate certain customer service expenses, such as 24/7 support costs, between ACC and AMM. Allband also developed a “corporate operations general allocator,” which Allband applies to common time generated from two executive employees including human resources management (672000), board meetings (671100), executive oversight (671100), and accounting & finance analysis (672100).

Second, much like with corporate operations time, Allband developed a “total company general allocator,” which Allband applies to other common expenses that relate to both ACC and AMM and which are not associated with a specific category such as customer service or corporate expense. For example, the total company general allocator would apply to expenses such as the repair of general office equipment (e.g., fax machine) or general office supply costs. The table below details how the different allocators separate time between ACC and AMM in the second quarter of 2016.

USAC reviewed, as part of our testing, the treatment of time associated with executive oversight and accounting & finance labor. USAC noted that Allband directly assigns time for these activities as either ACC or AMM where applicable, but, for common time, Allband utilizes the above referenced corporate operations general allocator. Although USAC did not specifically test legal expenses as part of its sample, USAC noted that Allband’s process is similar for the treatment of legal costs. Allband directly assigns legal costs to ACC or AMM where applicable. For common legal costs, Allband separates these costs into a separate section of the general ledger and then applies the total company general allocator discussed above.

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Allband claims only pertain to the regulated entity . . . . Moreover, as stated above, in 2012 and 2013, Allband allocated virtually no corporate operations expenses at all to AMM, which would have meant its executives, management, and employees were spending practically no time on AMM matters.”); *see also id.* at para. 18 (“USAC [IAD] also found that during the waiver period from 2012 to 2014, Allband allocated all accounting and finance expenses to the regulated entity.”).

<b>Allband Communication's Use of Allocators (2<sup>nd</sup> Quarter 2016)</b>		
	<b>ACC Regulated</b>	<b>Non-Regulated ACC and AMM</b>
Corporate Operations General Allocator	43.48%	56.52%
Plant General Allocator	36.99%	63.01%
Customer Service General Allocator <sup>8</sup>	16.37%	83.63%
Total Company General Allocator	43.45%	56.55%

### **Non-compliance with Affiliate Transactions Rules**

Based on USAC's review, the affiliate transactions concern relating to allocation of expenses has been substantially addressed by Allband's changes to time reporting as discussed above. Allband's greatest commonly shared resource between ACC and AMM is labor costs. Hours are either directly assigned, if appropriate, or time is split up between ACC and AMM through the use of the corporate operations general allocator. USAC concludes that this method is a reasonable process for allocating employee time between the entities.

### **Inclusion of Improper Expenditures**

The *Allband Order* also concluded that Allband allocated improper expenditures to ACC.<sup>9</sup> USAC documented Allband's updated processes to determine whether only qualifying expenses were applied to the regulated entity. Allband engaged John Staurulakis Incorporated (JSI) to assist its controller with reviewing accounting practices including identifying and removing improper expenditures. Allband received a copy of JSI's Accounting Manual, which offers detailed discussion and guidance on Part 32 reporting. JSI provided on-site guidance on how to assign time for specific types of work functions that commonly occur at Allband. Allband management has stated in meetings that non-routine expenses will be reviewed closely by using the JSI Accounting Manual based on Part 32 USOA and that a year-end review will be performed on non-routine entries.

In order to determine whether Allband's additional controls were effective, USAC tested a total of 57 general ledger transactions occurring in the first and second quarters of 2016. The transactions were selected judgmentally by USAC staff since one of the testing goals was to select transactions from a wide range of expense accounts, especially expenses within the

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<sup>8</sup> Following completion of the February 24, 2017, version of this memo, Allband revised its customer service allocator. As described to USAC on a February 28, 2017, teleconference with Allband, the revised customer service allocator relies on customer service time that has been directly reported for ACC and for AMM in order to identify the relevant percentages that should apply to common customer service expenses. Customer service hours are pulled directly from the ACC timesheet, after the allocation of morning meeting hours, and then the ACC hours are separated into regulated and non-regulated categories. Similarly, customer service hours are pulled directly from the AMM timesheet, with no further separation since all AMM hours are non-regulated. The time identified for regulated ACC activities comprises approximately 16.4% of total customer service time. The time identified for non-regulated ACC activities and AMM activities comprises approximately 83.6% of total customer service time. These percentages will be applied to common customer service expenses such as 24/7 support that occur during the second quarter of 2016. A similar methodology will be applied to each quarter in 2016.

<sup>9</sup> *Id.* at para. 20 ("Allband allocated to the regulated entity expenditures that are not necessary for the provision of supported services and may not be recovered through high-cost support.").

“General and Administrative category.” Of the 57 transactions selected, USAC identified eight exceptions and proposed alternate classifications. USAC notes that the majority of the eight exceptions involved complex classifications and a degree of subjectivity. In all instances, Allband agreed to update its process for reporting expenses and to ensure the process was uniformly applied in the future. Exhibit II provides further details for the eight exceptions.

## Conclusion

Consistent with paragraph 23 of the *Allband Order*, USAC has reviewed Allband’s revised accounting practices. The discussion above captures Allband’s added controls to address the concerns raised by the Commission in the *Allband Order* and details USAC’s testing to evaluate the effectiveness of the updates Allband made to its accounting practices. Based on its test work, Allband appears to have adjusted its cost accounting practices to substantially comply with the FCC’s rules for cost allocation between regulated and nonregulated activities.

Allband was provided an opportunity to review and respond to this report; Allband’s comments are included below in the section entitled “Allband Response” as well as in the column entitled “Allband Comments on Corrective Action” in Exhibits I and II. Allband has not requested confidential treatment of any of the information contained in this report. Please let us know if we can answer any questions or provide additional supporting documentation.

## Allband Response (March 27, 2017)

Allband appreciates USAC’s cooperation and the opportunity to provide comments and feedback as follows:

- I. Allband would like to reinforce that it has been fully cooperative and diligent in working with USAC to resolve all of the apparent issues raised by the Commission’s Orders. This has included the exchange of numerous emails and documents, conference calls, in-person meetings, completing studies, and reporting results to USAC. Discussions and reviews involving USAC staff and Allband and its consultants support Allband’s assertions that Allband is currently unaware of any remaining inconsistencies between its accounting and the FCC’s interpretations of its Accounting Rules for 2016, and that Allband is sincerely committed to ensuring compliance with all reasonable FCC interpretations of its Accounting Rules on a prospective basis.
- II. The USAC report contains certain "hedging" language as identified in the below table, that if misinterpreted, could elude to some level of uncertainty regarding Allband’s compliance with FCC rules. Allband, through its intensive efforts and cooperation with USAC to demonstrate compliance, would prefer to use language that demonstrates certainty, which could be reinforced by the removal of such language.

Reference	Original Text	Hedging
Page 5 Paragraph 1	Based on USAC’s review, the affiliate transactions concern	Remove the word: substantially

	relating to allocation of expenses has been <b>substantially</b> addressed	
Page 6 Paragraph 2	Based on its test work, Allband <b>appears to have</b> adjusted its cost accounting practices to <b>substantially</b> comply with the FCC's rules for cost allocation between regulated and nonregulated activities.	Remove the words: appears to have and substantially

- III. Allband would like to place further emphasis on its efforts to become compliant by notating the following activity in addition to the statements made by USAC located at **Page 2, Paragraph 4** of the report:

*Allband promptly hired an additional consulting firm, JSI, expressly for the purpose of implementing a Corrective Action Plan to conduct Part 32 training, reviewing procedures, etc. in addition to the other steps Allband promptly implemented as part of its revised procedures.*

- IV. Allband, through its discussions with USAC, identified several instances where exceptions were subjected to interpretation of the rules and required clarification. Therefore, Allband would like to acknowledge said interpretations by suggesting the following changes to **Page 3, Paragraph 2** as highlighted in bold and via strike-outs below:

*The fourth exception involved ~~misusing~~ **a misunderstanding of the use of** the general computer expense account. USAC explained the **limited** exceptions **found during the review** and educated Allband about how to allocate employee time using the appropriate account. Allband has indicated that it now understands **fully** the proper use of the general computer expense account, and that in the future similar employee time will be properly allocated instead of being automatically assigned to the general computer expense account.*

#### **USAC Response to Allband's Response II**

USAC conducted a targeted review utilizing samples and has not undertaken a comprehensive audit to assess Allband's compliance with the FCC's rules. To the extent that definitive conclusions may be drawn based on the sampling, these conclusions have been stated.

## EXHIBIT I: Employee Time Reporting Exceptions

General Ledger Account	General Ledger Name	Pay Period	Conclusion	Allband Comments on Corrective Action
612400	General Computer Expense	4/30/16	This employee was not performing computer operations to get the computer to run such as a hardware adjustment or an operating system installation. The employee was installing Office 365, a software service intended to support all operations within the company. This time should thus be reported based on where the application being installed is expected to contribute to providing service.	USAC provided Allband with further clarification for the General Computer Expense that determined that account 6124 is not the appropriate expense account for assigning software. This software is used across the entire scope of business and is now assigned to 672030 and allocated accordingly with the "Total Company Allocator" assigning a portion to AMM and ACC Non-reg.
653300	Update RT tickets	4/9/16	Allband could not locate supporting documentation and USAC was unable to conclude on the accuracy of time reporting for this specific transaction.	Allband, along with its consultant JSI, held a training session with employees in September 2016. As part of this training, one of the items that was stressed is why it is important to include customer names and work order numbers on the daily time sheets. JSI explained that including this kind of detail is an integral part of providing supporting documentation for auditing and compliance purposes. Allband management's review of time sheets will ensure this practice continues on an on-going basis
661300	Marketing	4/9/16	Allband could not locate supporting documentation and USAC was unable to conclude on the accuracy of time reporting for this specific transaction.	Allband along with its consultant JSI, held a training session with employees in September 2016. As part of this training, one of the items that was stressed is why it is important to include customer names and work order numbers on the daily time sheets. JSI explained that including this kind of detail is an integral part of providing supporting documentation for auditing and compliance purposes. Allband management's review of time sheets will ensure this practice continues on an on-going basis



672000	Business Model	4/9/16	Allband could not locate supporting documentation and USAC was unable to conclude on the accuracy of time reporting for this specific transaction.	Allband, along with its consultant JSI, held a training session with employees in September 2016. As part of this training, one of the items that was stressed is why it is important to include customer names and work order numbers on the daily time sheets. JSI explained that including this kind of detail is an integral part of providing supporting documentation for auditing and compliance purposes. Allband management's review of time sheets will ensure this practice continues on an on-going basis
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## Exhibit II: Improper Expenditure Exceptions

General Ledger Account	General Ledger Name	General Ledger Description	General Ledger Amount	Conclusion	Allband Comments on Corrective Action
672000	General and Admin Exp	Neimans	\$14.71	Per FCC 15-133, food unrelated to business travel should not be reported as a regulated expense.	Following clarification from USAC as to what is includable as a regulated food expense, Allband has created a separate, <u>non-regulated</u> general ledger account which serves to both identify and separate non-travel related food expenditures for exclusion from the regulated studies and filings.
672000	General and Admin Exp	Subway	\$25.02	Per FCC 15-133, food unrelated to business travel should not be reported as a regulated expense.	Following clarification from USAC as to what is includable as a regulated food expense, Allband has created a separate, <u>non-regulated</u> general ledger account which serves to both identify and separate non-travel related food expenditures for exclusion from the regulated studies and filings.
612400	General Purpose Computer Exp	Industrial Image, Inc.	\$210.00	Website expenses should be allocated based on the areas benefitting from the cost – in this case to marketing (6610), customer service (6623), and general & administrative (6720).	With further clarification from USAC on what is appropriate to include in the 6124 account, Allband now assigns based upon the areas that benefit from the expenditure, in this case the website expenditures would be assigned to marketing (6610), customer service (6623), and general & administrative (6720).
612400	General Purpose Computer Exp	Lynda	\$25.00	This tool supports software used across the company for various purposes and would be appropriately reported in general & administrative (6720).	USAC provided Allband with further clarification regarding General Computer Expense which determined that software is not to be assigned to this expense account. This software is used across the entire scope of business and is now assigned to 672030 and allocated accordingly with the “Total Company Allocator” which assigns a portion to AMM and ACC Non-reg.

612400	General Purpose Computer Exp	Apple Online Store	\$95.40	This cost represents an accessory to an iPad and should be allocated based on other time reported by the individual making use of the device.	With further clarification from USAC for the General Purpose Computer Expense, Allband reassigned this expense to a clearing account which is then cleared to the respective accounts based upon the employee's time reporting for the quarter.
653400	Plant Oper. Admin Exp	Nicholas A Domke	\$200.00	This clothing allowance should be reported based on the other time reported by the individual in question. In this case, time would be reported according to outside plant technician time reporting.	With further clarification from USAC for the Plant Oper. Admin Expense, Allband reassigned this expense to a clearing account which is then cleared to the respective accounts based upon the employee's time reporting for the quarter.
672000	General & Admin Exp	Vista Print	\$26.49	These business cards were to support the Sales and Administration Coordinator and, as such, should be classified as marketing (6610).	With further clarification from USAC, Allband will assign business cards expense to marketing.
672000	General & Admin Exp	Industrial Image, Inc.	\$600.00	Website expenses should be reported based on the areas benefitting from the cost – in this case to marketing (6610), customer service (6623), and general & administrative (6720).	With further clarification from USAC on what is appropriate to include in the 6124 account, Allband now assigns based upon the areas that benefit from the expenditure, in this case the website expenditures would be assigned to marketing (6610), customer service (6623), and general & administrative (6720).